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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

**Telecommunications Division
Market Structure Branch**

**RESOLUTION T-16856
October 7, 2004**

R E S O L U T I O N

**Resolution T-16856. SureWest Telephone Company (U-1015-C).
Order accepting subject to Commission corrections or adjustments,
SureWest's Annual Intrastate Earnings Advice Letter Filing in
Compliance with Decision 96-12-074.**

**By Advice Letter No.932 and No.932A filed on April 23, 2004 and
July 14, 2004, respectively.**

Summary

SureWest Telephone (SureWest) filed its annual intrastate shareable earnings through Advice Letters (AL) No.932 and 932A in compliance with D.96-12-074. SureWest reported its intrastate earnings calculation for the twelve months ending December 31, 2003 at 12.15%. As a result of the earnings being in excess of the benchmark rate of return (ROR), SureWest's earnings is subject to a 50% refund to ratepayers. However, as part of a proceeding reviewing SureWest's Petition for Modification of D.01-06-077, A.99-03-025, SureWest and the Office of Ratepayers Advocates (ORA) have reached a Settlement Agreement on a specific shareable earnings amount for 2003.

This resolution grants SureWest's AL No. 932A that requests deferring the 2003 shareable earnings amount to the final decision in the Petition for Modification of D.01-06-077, A.99-03-025.

Background

New Regulatory Framework (NRF)

Pursuant to D.96-12-074, the Commission authorized a new regulatory framework (NRF) for SureWest similar to that originally adopted for SBC California and Verizon California in D. 89-10-031. The Commission replaced cost-of-service

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regulation for SBC and Verizon with incentive-based regulation. Commonly known as the “price cap” model, NRF is centered around a price cap indexing mechanism, with sharing of excess earnings above a benchmark rate of return level. The price cap model updates revenues yearly for inflation and expected productivity improvements for the telecommunications industry.

Under NRF, carriers are given the opportunity to earn a return above that which would be authorized under traditional cost-of-service regulation. In developing a NRF program for SureWest, the Commission established two protections against an improperly functioning indexing mechanism. The Commission set up an earnings floor that protects shareholders against unreasonably low earnings. For SureWest, the Commission adopted a floor ROR (6.75%) to provide comparable protection for shareholders in the event that indexing mechanism seriously underestimates revenues needed to provide earnings level reasonably close to the market based ROR.

The Commission also adopted an earnings sharing mechanism to provide a protection to ratepayers from unreasonably excessive profits for the utility. The sharing mechanism employs several ROR thresholds:

A market-based ROR (10.00%) that reflects what a reasonable market driven ROR would be for a similarly situated utility with comparable risk.

A benchmark ROR 150 basis points (11.50%) higher than the market-based ROR to provide a strong profit incentive to the utility to operate more efficiently. The benchmark ROR is the trigger for sharing excess earnings with ratepayers.

A cap (ceiling) ROR (15.00%) to protect ratepayers against the indexing mechanism that results in unreasonably high prices and excessive profits for the utility.

SureWest is required to file an annual advice letter reporting its intrastate earnings for each year to determine whether shareable earnings exist. The filing is required to be made no later than April 1 of the following year. Under the sharing mechanism, SureWest retains 100% of its earnings up to the benchmark ROR, shares with ratepayers 50% of its earnings between the benchmark and cap RORs, and refunds to ratepayers 100% of its earnings above the cap ROR.

SureWest's Annual Shareable Earnings Filing

Pursuant to Ordering Paragraph 7 of D. 96-12-074, SureWest is required to file its annual intrastate shareable earnings advice letter (AL) by April 1 for the purpose of

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reporting its actual earned ROR for the preceding year and determining whether shareable earnings exist. On March 19, 2004, SureWest requested an extension of an additional three weeks to file the annual sharing report. On April 1, 2004, SureWest's request for an extension was granted.

On April 23 2004, SureWest filed its intrastate shareable earnings in AL No.932. SureWest reported its intrastate earnings calculation for the twelve months ending December 31, 2003 at 12.15%. Other references reported in SureWest's filing included the following rates of return:

Market-Based	10.00%
Benchmark	11.50%
Ceiling	15.00%

As a result of the earnings being in excess of the benchmark ROR, SureWest's earnings is subject to a 50% refund to ratepayers. SureWest estimates the amount to be refunded to ratepayers to be \$779,758.

Notice/Protests

SureWest states that a copy of the AL was mailed to competing and adjacent utilities and/or other utilities and interested parties as requested. Notice of AL No.932 and 932A was published in the Commission Daily Calendar of May 5, 2004 and July 16, 2004, respectively.

ORA filed a timely protest to AL No.932 on May 20, 2004. ORA notes that SureWest's reported ROR is likely to be modified based on an audit being conducted by ORA. Also, in May 2002, SureWest filed a petition to modify the sharing mechanism adopted in D.01-06-77. Because the sharing mechanism that SureWest proposed to modify is partly based on the prior audit, ORA conducted a follow-up audit to determine whether the problems identified in D.01-06-077 persist. ORA's follow-up audit included reviewing SureWest's intrastate ROR for the past several years, including 2003. As a result of this audit process, SureWest has agreed to some of ORA's proposed audit adjustments and disagrees with others. In that proceeding, the Commission will determine the appropriate rates of return for the audited years for SureWest. For these reasons, ORA believes that SureWest will need to modify its rates of return based on the Commission decision.

ORA did not recommend refunding at this time the \$779,758 in shareable earnings identified in AL No.932. ORA believes it is premature for the Commission to accept SureWest's 2003 ROR as filed in AL No.932. ORA is currently verifying SureWest's ROR, and the outcome will be determined by the Commission later this year.

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Adopting AL No.932 with the intrastate ROR at 12.15 percent prior to the follow-up audit will inappropriately prejudge the outcome of SureWest's petition. Therefore, ORA recommends that the Commission defer its resolution in adopting SureWest's 2003 ROR and shareable earnings based on the results of the Commission's decision in the petition to modify D.01-06-077.

On June 3, 2004, the Telecommunications Division (TD) contacted SureWest asking whether they had filed, or intended to file a response to the protest. On June 7, 2004, SureWest informed TD that it has not received ORA's protest. Therefore, TD faxed a copy of ORA's protest to the company.

On June 14, 2004 Cooper, White & Cooper, LLC (Cooper) filed a response to the protest on behalf of the company. SureWest does not oppose ORA's suggestion, and believes that the Commission should accept its shareable earnings filing subject to any corrections or adjustments to its earnings, which may be appropriate as a result of the petition for modification. Furthermore, upon the resolution of the proceeding, SureWest would file a subsequent AL to take into account the impacts, if any of the petition for modification and include appropriate interest on the shareable earnings amount.

On July 14, 2004 SureWest filed AL supplement 932A. SureWest noted that as part of a proceeding reviewing SureWest's Petition for Modification of D.01-06-077, A.99-03-025, SureWest and ORA have reached a Settlement Agreement on a specific shareable earnings amount for 2003. The agreement is being formalized to be submitted for Commission approval and decision in that proceeding. Accordingly, SureWest requests that the outcome of AL No.932 and the supplement be deferred to the final decision in A.99-03-025. SureWest states that such a deferral will avoid duplication of effort, saving resources for all parties and minimizing potential customer confusion that would result from implementing a 2003 shareable earnings amount in two different proceedings.

Discussion

Since the 2003 shareable amount has changed pursuant to the Settlement Agreement, it would be premature to require SureWest to refund the shareable amount at this time. Therefore, TD agrees with ORA and SureWest and finds it reasonable to defer the approval of SureWest's 2003 intrastate shareable earnings filing as ORA suggests.

On July 28, 2004, ORA and SureWest jointly filed a letter notifying TD that the parties reached the Settlement Agreement. By the agreement, without settling any specific accounting or ratemaking issues that were raised in the proceeding, SureWest agrees to pay \$6.2 million in consumer dividends to end users for the shareable earnings obligations related to years 2000, 2001, 2002 and 2003. ORA and

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SureWest thereby recommend that TD defer its resolution of AL 932 until the Commission acts on the parties' Motion to Approve the Settlement Agreement.

TD recommends that disposition of SureWest AL 932 and 932A be deferred to the Commission decision in the petition to modify D.01-06-077, A.99-03-025. We agree with TD's recommendation and defer to a final decision regarding SureWest's petition for modification of D.01-06-077 in A.99-03-025.

Comments

In accordance with P.U. Code Section 311 (g) TD mailed a copy of the original draft resolution on September 7, 2004 to SureWest and other interested parties. Comments received on a timely basis will be addressed in any final resolution.

Findings

- 1) SureWest filed an extension and was granted to file its intrastate shareable earnings until April 22, 2004.
- 2) On April 23, 2004, SureWest filed its sharable earnings in AL No.932.
- 3) SureWest reported its ROR for year 2004 was 12.15%.
- 4) As a result of the earnings being in excess of the benchmark ROR, SureWest's earnings is subject to a 50% refund to ratepayers.
- 5) The estimated annual revenue effect to be refunded to ratepayers is \$779,758.
- 6) Information contained in SureWest's AL including the reported ROR has not been audited.
- 7) ORA filed a timely protest on May 20, 2004, recommending that the Commission defer its resolution in adopting SureWest's 2003 ROR and shareable earnings based on the results of the Commission's decision in the petition to modify D.01-06-077.
- 8) On June 14, 2004 Cooper, White & Cooper, LLC (Cooper) filed a response to the protest on behalf of the company. SureWest does not oppose ORA's suggestion, and believes that the Commission should accept its shareable earnings filing subject to any corrections or adjustments to its earnings, which may be appropriate as a result of the petition for modification.
- 9) No deficiency in AL No.932 has been identified at this time.

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10) The reference RORs are as follows:

- Floor: 6.75% (- 325 basis points)
- Market-Based: 10.00%
- Benchmark: 11.50% (Market-based + 150 basis points)
- Ceiling: 15.00% (Market-based + 500 basis points)

11) On July 14, 2004, SureWest filed a supplement requesting the outcome of AL 932 and 932A to be deferred to the final decision in A.99-03-025.

12) On July 28, 2004, ORA and SureWest jointly filed a letter to notify TD that the parties have reached the Settlement Agreement.

13) After reviewing the protest and response, we find ORA's protest to be timely. We find that disposition of AL No.932 and 932A should be deferred to the Commission's decision in the petition to modify D.01-06-077, A.99-03-025.

THEREFORE, IT IS ORDERED that:

1. Disposition of SureWest's Annual Intrastate Earnings Advice Letter No.932 and No.932A shall be deferred to a final Commission decision in the Petition for Modification of D.01-06-077, A.99-03-025.

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This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on October 7, 2004. The following Commissioners approved it:

STEVE LARSON
Executive Director